Supreme Court, U.S.
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CLERK

No. 86-543

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

PAINE, WEBBER, JACKSON & CURTIS, INC., SMITH BARNEY, HARRIS UPHAM & CO. INCORPORATED and DONALD J. PORTER,

Petitioners,

vs.

MARILYN E. BURRIS,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

The United States Arbitration Act, 9 U.S.C. §§ 1-14 ("Arbitration Act"), mandates the enforcement of arbitration agreements. This Court, however, has left open the issue of whether predispute agreements to arbitrate possible claims under § 10(b) of the Securities Exchange Act of 1934 (" 10(b)"; "1934 Act") may be compelled.

1. Does a party's federally protected right to compel the arbitration of disputes pursuant to the Arbitration Act extend to judicially implied causes of action under the federal securities laws?

2. Does the decision below of the Third Circuit, refusing to compel arbitration of implied causes of action under the federal securities laws, conflict with this Court's recent decisions in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346 (1985)?

STATEMENT PURSUANT TO RULE 28.1

The parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of the corporate petitioners are:

Paine, Webber, Jackson & Curtis, Inc.
PaineWebber Incorporated, formerly known as Paine, Webber, Jackson & Curtis, Inc., is a wholly owned subsidiary of PaineWebber Group Inc.
Paine Webber Cash Fund Inc.
Paine Webber RMA Money Fund Inc.
Paine Webber Atlas Fund Inc.
Paine Webber Olympus Fund Inc.
Paine Webber America Fund Inc.
Paine Webber Fixed Income Portfolios Inc.
Paine Webber California Tax Exempt Income Fund Inc.
Paine Webber Tax Exempt Income Fund Inc.
Paine Webber Master Series Inc.
Regional Financial Shares Investment Fund Inc.
Cypress Fund Inc.
Smith Barney, Harris Upham & Co. Incorporated
Smith Barney, Inc.
Corporate Realty Income Fund
First Century Partnership II
First Century Partnership III
Government Liquid Reserves, Inc.
GVM Partners
Naterm Corporation
National Liquid Reserves, Inc.
SBHU Life Agency of Ohio, Inc.
SBHU Life Agency of Oklahoma, Inc.
SBHU Life Agency of Texas, Inc.
Smith Barney Equity Fund, Inc.
Smith Barney Mortgage Capital Corp.
The Tax Free Money Fund, Inc.
Vantage Money Market Funds

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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

PAINE, WEBBER, JACKSON & CURTIS, INC., SMITH BARNEY, HARRIS UPHAM & CO. INCORPORATED and DONALD J. PORTER,

Petitioners,

vs.

MARILYN E. BURRIS,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

OPINIONS BELOW

The opinion of the court of appeals is reported *sub nom. Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, at 797 F.2d 1197 (3d Cir. 1986). The orders and opinions of the district court are not reported.

JURISDICTION

The judgment of the court of appeals was issued August 11, 1986 and was filed at 8:30 a.m. on September 3, 1986. (App. A.) An order staying issuance of the Third Circuit's mandate until final disposition by this Court was entered September 8, 1986. (App. C.) Jurisdiction in this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved in this case are set forth in full in the appendix. (App. D.) The citations to the statutes and regulations are as follows:

United States Arbitration Act,

Section 2, 9 U.S.C. § 2

Securities Act of 1933,

Section 12(2), 15 U.S.C. § 77l(2)

Section 14, 15 U.S.C. § 77n

Section 22(a), 15 U.S.C. § 77v(a)

Securities Exchange Act of 1934,

Section 10(b), 15 U.S.C. § 78j(b)

Section 27, 15 U.S.C. § 78aa

Section 29(a), 15 U.S.C. § 78cc(a)

Securities and Exchange Commission,

Rule 10b-5, 17 C.F.R. § 240.10b-5

STATEMENT OF THE CASE

Marilyn E. Burris, Respondent, brought this action against Petitioners Smith Barney, Harris Upham & Co. Incorporated ("Smith Barney"), Paine, Webber, Jackson & Curtis, Inc. ("Paine Webber") and Donald J. Porter in the United States District Court for the District of New Jersey by filing a Summons and Verified Complaint on August 17, 1983. The complaint alleged various state law and federal law claims in connection with her securities accounts, including alleged violations of § 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

By motion dated November 15, 1983, Smith Barney sought an order dismissing all claims arising under the federal securities laws and internal industry rules pursuant to Fed.R.Civ.P. 9(b) and 12(b)(6), severing and staying all pendent state law claims, and compelling the arbitration of those pendent claims in accordance with pre-dispute arbitration agreements executed by Respondent. Paine Webber and Porter joined in the motion. The arbitration motion remained under consideration until August 3, 1984, when Judge Sarokin rendered a bench opinion and an order was entered granting Petitioners' motion and compelling arbitration of Ms. Burris's pendent state law claims. (App. B.) The arbitration proceeding was stayed, however, pending the conclusion of litigation relating to her federal securities claims. *Id.*

Thereafter, on April 9, 1985, following the issuance of this Court's opinion in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985), Smith Barney, joined by Paine Webber and Porter, moved to compel arbitration of the remaining 1934 Act claims and to vacate the previously imposed stay of the arbitration of plaintiff's pendent state claims. In a July 8, 1985 bench opinion, formalized by order entered July 24, 1985 (App. B), Judge Sarokin vacated the stay but denied the motion to compel arbitration of Respondent's federal securities law claims, largely on the basis of the Third Circuit's previous decision in *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

The Third Circuit affirmed Judge Sarokin's order of July 24, 1985, specifically finding that it was bound to follow its decision in *Ayres* in the absence of a Supreme Court decision specifically overruling *Ayres*. (App. A.) It is from this decision that Petitioners seek a Writ of Certiorari.

REASONS FOR GRANTING THE WRIT

For many years, the federal courts had refused to enforce arbitration agreements between brokerage firms and their customers in disputes involving implied causes of action under the federal securities laws. This policy was questioned by this Court in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985), and effectively rejected by this Court's subsequent reasoning in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S.Ct. 3346 (1985). Notwithstanding this Court's teachings in *Byrd* and *Mitsubishi*, the United States Court of Appeals for the Third Circuit and a number of other lower courts continue to deny parties their federally protected right to arbitrate disputes involving implied claims under the federal securities laws.

The majority of district courts which have addressed this issue have compelled arbitration of implied federal securities law claims in light of *Byrd* and *Mitsubishi*. However, the burgeoning patchwork of disparate holdings by the lower courts and the split in the circuits on this issue renders arbitration agreements involving customers of national and local securities firms, all engaged in interstate commerce across the nation, of uncertain enforceability. This uncertainty as to the state of the law has precipitated an eruption of federal litigation over this question, to the detriment of the securities industry, the investing public, and the judicial system. For this reason, as well as those to follow, there is an urgent need for this Court to resolve this timely and controversial question.

I.

THE DECISION OF THE COURT OF APPEALS FOR THE THIRD CIRCUIT, WHILE IN AGREEMENT WITH THE DECISIONS OF THE SECOND,[1] NINTH,[2] AND ELEVENTH[3] CIRCUITS, CONFLICTS WITH THE DECISION OF THE EIGHTH[4] CIRCUIT.

Since this Court's decision in *Dean Witter Reynolds Inc. v. Byrd*,[5] the courts of appeals which have considered the enforceability of agreements to arbitrate claims under § 10(b) of the 1934 Act have rendered conflicting decisions. The Second, Ninth, and Eleventh Circuits, and now the Third Circuit, have refused enforcement of agreements to arbitrate claims arising under § 10(b), relying almost exclusively on precedent within each circuit decided prior to *Byrd* and *Mitsubishi*. In contrast, the Eighth Circuit has held that agreements to arbitrate claims asserted under § 10(b) are enforceable, concluding, after analysis of the issues, that Congress had created no exception to the mandate of the Arbitration Act for judicially implied rights of action under § 10(b) and Rule 10b-5.

Resolution of this conflict among the circuits is necessary in order to achieve uniform application of federal law. Parties in the Second, Third, Ninth, and Eleventh Circuits currently are being denied their contractual right to arbitration based on an

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[1] *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), petition for cert. filed, 55 U.S.L.W. 3032 (U.S. July 14, 1986) (No. 86-44) (requesting review by certiorari of the denial of arbitration of both a §10(b) claim and a claim under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1961, *et seq.*).

[2] *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986).

[3] *Miller v. Drexel Burnham Lambert, Inc.* 791 F.2d 850 (11th Cir. 1986) (per curiam).

[4] *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393 (8th Cir. 1986).

[5] 105 S.Ct. 1238 (1985).

overly broad reading of this Court's decision in *Wilko v. Swan.*[6] In the instant case, the Third Circuit, following *Ayres* and its overly broad extension of *Wilko*, refused to consider arguments to the contrary and stated, "Because no subsequent Supreme Court decision may fairly be read to have overruled *Ayres*, that opinion binds this panel. An extended discussion of the reasons advanced by the brokerage firms concerning why *Wilko* should not apply to Section 10(b) claims is therefore inappropriate."[7]

As the Eighth Circuit in *Phillips*[8] observed, the analysis in *Wilko* was performed in the context of what was perceived to be a direct statutory conflict between the express right of action for purchasers granted under § 12(2) of the 1933 Act and § 2 of the Arbitration Act,[9] which mandates enforcement of arbitration agreements. By contrast, no such statutory conflict is present in the instant case where, as this Court noted in *Scherk v. Alberto-Culver Co.*,[10] "[t]here is no statutory counterpart of § 12(2) in the Securities Exchange Act of 1934, and neither § 10(b) of that Act nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged here." In the absence of a direct statutory conflict, a purported analysis of the policies underlying the 1934 Act is both erroneous and unnecessary,[11] and the language of the Arbitration Act which this Court has held "[b)y its terms... mandates that district courts *shall* direct the parties

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[6] 364 U.S. 427 (1953). Indeed Petitioners suggest the Court should overrule or expressly limit *Wilko v. Swan* to the specific sections of the Securities Act of 1933 ("1933 Act") at issue there.

[7] 797 F.2d at 1202 (App. A-13).

[8] 795 F.2d at 1394-95.

[9] 9 U.S.C. §2.

[10] 417 U.S. 506, 513 (1974).

[11] The Third Circuit did not even purport to analyze these arguments and moreover ignored the "liberal federal policy favoring arbitration agreements" as "manifested by [§ 2 of the Arbitration Act] and the Act as a whole...." *Mitsubishi Motors v. Soler-Chrysler-Plymouth, supra*, 105 S.Ct. at 3353 (1985).

to proceed to arbitration on issues as to which an arbitration agreement has been signed"[12] must prevail.

Moreover, as the Eighth Circuit in *Phillips* noted, the *Wilko* decision was premised not only upon the language of § 14 of the 1933 Act,[13] which voids any "condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter," but also upon the "special" nature of the right to recover under § 12(2) and the right under § 22(a) of the 1933 Act[14] to bring suit in either state or federal court.[15] The special nature of the right to recover for misrepresentations under §12(2), where "the seller is made to assume the burden of proving lack of scienter,"[16] is not present in the judicially implied remedy under § 10(b) of the 1934 Act which is "not so different from the common law action."[17] The choice of forum under § 22(a), the "provision" which this Court held could not be waived under § 14 in *Wilko*, is similarly not present in § 29(a) of the 1934 Act,[18] where jurisdiction is restricted to federal court. While this restriction might seem "an even more forceful indication of Congress' intent that federal courts oversee the interpretation and application of the 1934 Act,"[19] if followed as a rule for

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[12] *Dean Witter Reynolds, Inc. v. Byrd, supra*, 105 S.Ct. at 1241 (original emphasis).

[13] 15 U.S.C. §77n.

[14] 15 U.S.C. § 77v(a).

[15] *Wilko v. Swan, supra*, 346 U.S. at 430-431.

[16] *Id.* at 431.

[17] *Dean Witter Reynolds, Inc. v. Byrd, supra*, 105 S.Ct. at 1244 (White, J., concurring).

[18] 15 U.S.C. §78aa.

[19] *Conover v. Dean Witter Reynolds Inc., supra*, 794 F.2d at 527.

inferring Congressional intent to prohibit arbitration, such a rule would foreclose arbitration of all exclusive federal statutory claims. This result has been rejected by this Court.[20]

In his concurring opinion to this Court's decision in *Byrd*, Justice White noted that "Wilko's reasoning cannot be mechanically transplanted to the 1934 Act."[21] The factors and concerns which led this Court in *Wilko* to deny enforcement of arbitration agreements as to § 12(2) claims simply are not present with respect to § 10(b) claims. This Court, therefore, should resolve the conflict among the circuits by holding that the Arbitration Act mandates arbitration of judicially implied claims under § 10(b) when those claims are otherwise referable to arbitration under an agreement between the parties.

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[20] *See Mitsubishi Motors v. Soler Chrysler-Plymouth*, 105 S.Ct. at 3346, 3353 (1985) ("we find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims").

[21] 105 S.Ct. at 1244.

II.

THE DECISION OF THE THIRD CIRCUIT CONFLICTS WITH THIS COURT'S ANALYSIS IN *BYRD* AND *MITSUBISHI*.

The holding of the Third Circuit below cannot be reconciled with this Court's teachings in *Byrd* and *Mitsubishi*. While *Mitsubishi* involved antitrust claims in the context of an international transaction, this Court systematically dismantled each and every intellectual underpinning of the *American Safety* doctrine under which domestic antitrust claims had been held non-arbitrable.[22]

Moreover, there is no principled basis for restricting *Mitsubishi* to either the field of antitrust law or to international transactions. Indeed, given this Court's willingness to entrust the administration of rights and remedies granted by Congress under the federal antitrust laws to a foreign arbitration tribunal applying foreign procedural laws, one must assume *a fortiori* that Congress was more than prepared and willing to entrust federal remedies under the securities laws to the experienced and learned arbitrators who serve on the arbitration panels of the securities exchanges and the National Association of Securities Dealers (all under the oversight and supervision of the Securities and Exchange Commission).

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[22] This doctrine draws its name from the decision in *American Safety Equipment v. J.P. Maguire*, 391 F.2d 821 (2d Cir. 1968), which held antitrust claims to be non-arbitrable as a matter of public policy notwithstanding any express congressional exception to the contrary.

III.

THERE IS A COMPELLING NEED THROUGHOUT THE JUDICIAL SYSTEM FOR THIS COURT TO RESOLVE THE ISSUE OF ARBITRABILITY OF IMPLIED FEDERAL SECURITIES LAW CLAIMS.

Few issues in the last year have caused more litigation and confusion among the lower courts than the arbitrability of implied federal securities law claims. The significant majority of district court decisions subsequent to *Byrd* have compelled arbitration of Rule 10b-5 claims. The question has been determined in a totally inconsistent manner by circuit courts and further appeals are still to be heard.[23] Moreover, there have been at least four prior petitions for writs of certiorari filed this term, and now pending, seeking to resolve this very issue.

The explosion of litigation over this question, as well as the disparity of results among the lower courts, cries out for final resolution by this Court. Because arbitration agreements are frequently embodied in routine securities and commodities account documentation, a significant number of the thousands of federal securities claims filed annually would undoubtedly be submitted to arbitration, and substantial congestion of the federal dockets would be alleviated were this Court to hold judicially implied federal securities claims arbitrable under such agreements.

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[23] *See, e.g.*, partial listing contained in n.2 to the Third Circuit's opinion below. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 797 F.2d at 1199-1200 n.2 (App. A-7 to -9 n.2).

CONCLUSION

The decision by the Third Circuit below conflicts not only with this Court's opinion in *Dean Witter Reynolds, Inc. v. Byrd, supra,* and this Court's holding in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., supra,* but also with this Court's announced policy of vigorously enforcing the Arbitration Act. Review of the questions raised by this petition not only would vindicate the integrity of this Court's prior holdings, but also would vindicate the federally protected right of countless individuals and financial institutions to arbitrate judicially implied claims arising under the federal securities laws. Finally, a decision by this Court would relieve the lower courts of the proliferation of litigation over this issue that was precipitated by *Dean Witter Reynolds, Inc. v. Byrd.*

For these and the foregoing reasons, Petitioners respectfully request that this petition for a writ of certiorari to the United States Court of Appeals for the Third Circuit be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 85-3282, 85-3311 and 85-3343

ESTELLE JACOBSON AND CYNTHIA CARSON
Appellants in Nos. 85-3311 and 85-3343

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.
and ROBERT M. KOLACZYNSKI,
Appellants in No. 85-3282

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN
DISTRICT OF PENNSYLVANIA - PITTSBURGH
D.C. Civ. No. 84-1844

Argued April 17, 1986
Before: ADAMS, GIBBONS, and MANSMANN,
Circuit Judges

Nos. 85-5517 and 85-5542

MARILYN E. BURRIS

v.

PAINE, WEBBER, JACKSON and CURTIS, INC.,
SMITH BARNEY, HARRIS UPHAM & CO., INC.,
and DONALD J. PORTER
Smith Barney, Harris Upham
& Co., Inc., Appellant

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF NEW JERSEY - NEWARK
D.C. Civ. No. 83-3087

Submitted Under Third Circuit
Rule 12(6) April 14, 1986

No. 85-5439

ELLIS GANT

v.

KIDDER, PEABODY & CO., INC. and FRANK E.
GATTA, JR., Jointly and Severally
Kidder, Peabody & Co., Inc., Appellant

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF NEW JERSEY - NEWARK
D.C. Civ. No. 84-5025

Submitted Under Third Circuit
Rule 12(6) April 14, 1986

No. 85-5552

HERBERT BLUMENTHAL

v.

DEAN WITTER REYNOLDS INC. and
DANIEL J. TUROV
Dean Witter Reynolds Inc., Appellant

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF NEW JERSEY - NEWARK
D.C. Civ. No. 84-4799

Submitted Under Third Circuit
Rule 12(6) April 14, 1986

No. 85-1541

MICHAEL ERLBAUM

v

PRUDENTIAL-BACHE SECURITIES, INC. and
SAMUEL ALAN LIEBMAN

Appellants

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
EASTERN DISTRICT OF PENNSYLVANIA
D.C. Civ. No. 84-5541

Submitted Under Third Circuit
Rule 12(6) April 14, 1986
(OPINION FILED: AUGUST 11, 1986)

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---

OPINION OF THE COURT

GIBBONS, *Circuit Judge*:

This opinion deals with five interlocutory appeals presenting similar legal issues. All five appeals present the issue whether subsequent decisions of the United States Supreme Court have overruled this court's holding in *Ayers v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976), that claims against brokerage firms for violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)(1982), are not arbitrable. Two of the five appeals present the additional issue whether claims arising under sections 1962(a) and 1962(c) of the Racketeer Influenced and Corrupt Organization Act (RICO), 18 U.S.C. § 1962(a),(c) (1982), are arbitrable. Both these appeals present the issue whether a RICO claim is arbitrable

when the predicate offenses on which it is based are section 10(b) violations. One of the appeals also presents the issue whether RICO claims are arbitrable when the predicate offenses are mail and wire fraud.

All the appeals are properly before us.[1] We affirm the orders denying the brokerage firms' motions to compel arbitration of the section 10(b) claims. We reverse the portion of the order in *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Nos. 85-3282, 85-3311, and 85-3343, compelling arbitration of the RICO claim that was based on violations of section 10(b). We also reverse the portion of the order in *Blumenthal v. Dean Witter Reynolds, Inc.*, No. 85-5552, denying the motion to compel arbitration of RICO claims that are based on predicate acts of mail and wire fraud but affirm the portion of the order denying arbitration of a RICO claim based on section 10(b) violations.[2]

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1. Orders granting or denying motions to compel arbitration in actions seeking damages at law are appealable of right under 28 U.S.C. § 1292(a)(1982). *See, e.g.*, Cost Brothers, Inc. v. Travelers Indemnity Co., 760 F.2d 58, 59 n.1 (3d Cir. 1985); Rhone Mediterranee Compagnia v. Lauro, 712 F.2d 50, 51-52 (3d Cir. 1983); McCreary Tire & Rubber Co. v. CEAT, 501 F.2d 1032, 1034-35 (3d Cir. 1974). All notices of appeal were timely. While two of the district courts certified the § 10(b) arbitration question under 28 U.S.C. § 1292(b)(1982), such certifications were not necessary.

2. Our holding that RICO claims based on nonarbitrable predicate offenses are not arbitrable conflicts with the holding of the Court of Appeals for the Second Circuit in McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986). In addition our holding that § 10(b) claims are not arbitrable is consistent with the Court of Appeals for the Ninth Circuit decision in Conover v. Dean Witter Reynolds, No. 85-6082 (9th Cir. July 17, 1986 but conflicts with the holding of the Court of Appeals for the Eighth Circuit in Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No.85-5156 (8th Cir. July 9, 1986). According to the parties

I.

All the plaintiffs were customers with trading accounts at brokerage firms, and all executed agreements in which they consented to arbitrate all controversies arising out of transaction affecting their accounts. Typical of these agreements is the standard Customer Agreement used by Merrill Lynch, Pierce, Fenner & Smith, Inc. which provides,

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the issues presented by these appeals are pending in the following courts of appeals:

First Circuit

Mowbray v. Moseley, Hallgarten, Estabrook & Weeden, Inc., No. 83-2851-C (D. Mass. July 16, 1985) (appeal pending) (dealing with the arbitrability of § 10(b) claims).

Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 84-3240-N (D. Mass. July 19, 1985)(appeal pending) (dealing with the arbitrability of § 10(b) and RICO claims).

Third Circuit

Fabi v. Dean Witter Reynolds, Inc., No. 85-2881 (D.N.J. Nov. 21, 1985) (appeal pending)(§ 10(b) issue).

Horn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., appeal docketed, No. 86-5215 (3d Cir.) (appeal pending) (§ 10(b) and RICO issues).

Fourth Circuit

Land v. Dean Witter Reynolds, Inc., 617 F. Supp. 52 (E.D. Va. 1985)(appeal pending) (§ 10(b) and RICO issues).

Fifth Circuit

Beck v. Merrill Lynch, Pierce, Fenner & Smith, Inc., appeal docketed, No. 86-2051 (5th Cir.) (RICO issue only).

Smoky Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., appeal docketed, No. 85-1310 (5th Cir. Mar. 28, 1986) (request for rehearing pending) (RICO issue only).

Sixth Circuit

Lerchen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 83-CV-1479-DT (E.D. Mich. Nov. 29, 1985) (appeal pending) (§ 10(b) and RICO issues).

It is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the

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Sterne v. Dean Witter Reynolds, Inc., C-1-85-24 (S.D. Ohio Jan. 16, 1986) (appeal pending)(dealing with § 10(b) issue).

Drazdik v. Kidder Peabody & Co., Inc., C85-2442 (N.D. Ohio Mar. 3, 1986) (appeal pending) (§ 10(b) issue).

Eighth Circuit

Webb v. R. Rowland & Co., Inc., 613 F.Supp. 1123 (E.D. Mo. 1985) (appeal pending)(§ 10(b) issue).

Ninth Circuit

Badart v. Merrill Lynch, Pierce, Fenner & Smith Inc., No. 84-6448 (C.D. Cal. July 25, 1985) (appeal pending)(§ 10(b) issue).

Battershall v. A.G. Becker, Inc., appeal docketed, No. 85-6073 (9th Cir.) (appeal pending)(§ 10(b) issue).

Delman v. Merrill Lynch, Pierce, Fenner & Smith Inc., No. CV 84-3869 (C.D. Cal. June 25, 1985) (appeal pending)(§ 10(b) issue).

Hamling v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. CV 84-5194 (C.D. Cal. May 15, 1985) (appeal pending)(§ 10(b) issue).

Stratton v. Dean Witter Reynolds, Inc., No. 85-1028 (S.D. Cal. Aug. 12, 1985) (appeal pending)(§ 10(b) issue).

Felkner v. Dean Witter Reynolds, Inc., No. CV 84-3267 (C.D. Cal. May 6, 1985) (appeal pending) (RICO issue).

Eleventh Circuit

Gorman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., appeal docketed, No. 85-5419 (11th Cir. Dec. 19, 1985)(request for rehearing in banc granted)(§ 10(b) issue).

Miller v. Dean Witter Reynolds, Inc., No. 84-1079 (S.D. Ala. July 25, 1985) (appeal pending)(§ 10(b) issue).

Roberts v. Lehman Brothers Kuhn Loeb, Inc., No. 84-1421 (S.D. Fla. June 22, 1985) (appeal pending) (§ 10(b) issue).

Wolfe v. E.F. Hutton & Co., Inc., appeal docketed, No. 85-3352 (11th Cir. Dec. 29, 1985)(request for rehearing in banc granted) (§ 10(b) issue).

> Board of Governors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration of the National Association of Securities Dealers, Inc., as the undersigned may elect . . . . Arbitration must be commenced by service upon the other of a written demand for arbitration or a written notice of intention to arbitrate, therein electing the arbitration tribunal. In the event the undersigned [customer] does not make such a designation within five (5) days of such demand or notice, then the undersigned [customer] authorizes you to do so on behalf of the undersigned [customer].

Joint Appendix (*Jacobson v. Merrill Lynch*) at 292. All the plaintiffs incurred losses in investment accounts covered by similar arbitration agreements, and all the plaintiffs instituted suits claiming that those losses resulted from violations of federal securities laws, state statutory and common laws, and various securities-industry rules. In all five cases the district courts on the authority of *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238 (1985), granted motions to compel arbitration of the state-law claims. No appeal challenges those orders. In *Blumenthal*, No. 85-5552, the district court refused to order arbitration of the RICO claim, while in *Jacobson*, Nos. 85-3282, 85-3311, and 85-3343, the district court ordered arbitration of the RICO claim. Claims predicated upon securities-industry rules[3] have been dismissed and are not before us. Before considering the substantive legal issues presented by these appeals, a preliminary question concerning the coverage of the arbitration

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3. These claims should be distinguished from claims of violations of rules of the Securities and Exchange Commission. The latter claims were treated as section 10(b) claims.

agreements must be dealt with. In one of the five cases, *Gant*, No. 85-5439, the plaintiff argues that the broker amended the arbitration agreement to exclude claims arising under federal securities laws. The plaintiff contends, therefore, that because the arbitration agreement does not cover federal securities claims she is free to bring her suit in federal court. The logic of plaintiff's argument, however, is flawed.

Effective December 28, 1983 the Securities and Exchange Commission (SEC) promulgated a regulation making it a "fraudulent, manipulative or deceptive act" for a broker "to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws . . . ." 17 C.F.R. § 240.15c2-2(a) (1985). This regulation goes on to mandate that for agreements entered into prior to December 28, 1983, the broker is required to send a notice "no later than December 31, 1984" informing customers that the arbitration agreements they executed do not cover federal securities laws. *Id.* at § 240.15c2-2(c).

All the arbitration agreements involved in these five appeals were executed prior to December 28, 1983. Consequently, in at least one situation, the broker, Kidder, Peabody & Co, sent a notice informing the plaintiff that the arbitration agreement did not cover federal securities laws claims. In the case in which the plaintiff raises this issue, the notice was not received until after the complained of federal securities laws violations occurred. At best, therefore, the notice acted as an amendment at the time plaintiff's account was next traded following receipt of the notice. Hence, even if the notice constituted an amendment, it does not affect any of the claims before us.

II.

In *Wilko v. Swan*, 346 U.S. 427 (1953), the Supreme Court, relying on the anti-waiver provision in section 14 of the Securities Act of 1933, 15 U.S.C. § 77n, held that a claim for damages for violation of section 12(2) of that act, 15 U.S.C. § 77l(2), was not subject to contract arbitration. This court, in *Ayers v. Merrill Lynch, Pierce, Fenner & Smith*, 538 F.2d 532 (3d Cir. 1976), applied the *Wilko* rule to claims for damages for violation of section 10(b) of the Securities and Exc nge Act of 1934. Relying on the similar anti-waiver provision in section 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a), and on Congress' acceptance of the view that the *Wilko* rule applied to claims under the 1934 Act, this court expressly rejected the contention that *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974) should be read as confining *Wilko* to claims under the 1933 Act. *Ayers*, 538 F.2d at 536-37.

The *Ayers* opinion, which is consistent with this court's earlier discussion of the same issue in *Moran v. Paine, Webber, Jackson & Curtis*, 389 F.2d 242, 245-46 (3d Cir. 1968)(dicta),[4] binds this panel unless we can conclude that it has been overruled by subsequent Supreme Court cases. *See* Internal Operating Procedures of the United States Court of Appeals for the Third Circuit, chapter 8, section C. The brokerage firms rely on two Supreme Court cases that they contend accomplished that result. The first is *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238 (1985), which held that state law claims pleaded in a federal forum as pendent to claims under section 10(b) are arbitrable. The reasoning of that opinion, according to the brokerage firms, casts doubt upon *Ayers*. We disagree. In *Byrd* the Court took note of the

4. *See also Barrowclough v. Kidder, Peabody & Co.*, 753 F.2d 922, 940 n.17 (3d Cir. 1985).

line of cases in the lower federal courts applying the *Wilko* rule to section 10(b) claims and expressly declined to resolve the applicability of *Wilko* to section 10(b) claims. 105 S. Ct. at 1240 n.1. In the face of this express disclaimer the opinion cannot fairly be read as casting any doubt upon the continued authority of *Ayers* as precedent in this circuit.

The second case on which the brokerage firms rely is *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985). *Mitsubishi* held that an antitrust claim by an automobile dealer against a foreign automobile manufacturer was arbitrable. 105 S. Ct. at 3360-61. The Court in *Mitsubishi* rejected, as a rule of construction for arbitration agreements, the proposition that such clauses are inapplicable to federal statutory claims unless such claims are mentioned expressly. *Id.* at 3354-55. The issue presented in *Mitsubishi* was entirely different from that presented in *Ayers* and in *Wilko*. *Ayers* and *Wilko* did not involve interpretations of arbitration agreements; rather they involved interpretations of federal statutes that prohibit the application of forum-selection clauses. As Justice Blackmun carefully noted, "it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable." *Mitsubishi Motors*, 105 S. Ct. at 3355. The *Ayers* court identified section 29(a) of the 1934 Act as such a statute, and *Mitsubishi* does not undercut that statutory interpretation.

Because no subsequent Supreme Court decision may fairly be construed to have overruled *Ayers*, that opinion binds this panel. An extended discussion of the reasons advanced by the brokerage firms concerning why *Wilko* should not apply to section 10(b) claims is therefore inappropriate. The district

courts properly followed the *Ayers* precedent, and the orders denying motions to compel arbitration of section 10(b) claims will be affirmed in each appeal.

III.

The question whether RICO claims should be subject to arbitration is one of first impression in this court. The question is complicated by the unique structure of the RICO statute, which is aimed at "racketeering" activity, defined in terms of other federal and state statutes. *Mitsubishi* teaches that exceptions to the general enforceability of arbitration agreements pursuant to the Federal Arbitration Act must be found, if at all, in regulatory statutes. In the case of RICO claims this involves consideration both of the RICO statute and the predicate statutes that it cross-references.

Unlike the 1933 and 1934 securities acts, RICO contains no anti-waiver provision. Moreover, the civil remedy for RICO violations has "evolv[ed] into something quite different from the original conception of its enactors." *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985). Because the reach of the civil remedy has been achieved largely by the courts, it is not surprising that there is no legislative history suggesting that Congress ever considered whether RICO civil claims should be arbitrated. Despite the absence of a statutory provision that could be construed as a general prohibition against such arbitration, the Court of Appeals for the Second Circuit recently held that RICO claims, for reasons of public policy, are not arbitrable. *See McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98-99 (2d Cir. 1986). Presumably the public policy reasons that the *McMahon* court had in mind included the complexity of most RICO claims, the provision in the statute for recovery of treble damages, and the need for

developing the governing law on a case-by-case basis. We believe, however, that the *McMahon* court paid too little deference to the Supreme Court's decision in *Mitsubishi*. The *Mitsubishi* court concluded that "complexity should not suffice to ward off arbitration." 105 S. Ct. at 3357. The antitrust laws are every bit as complex and in need of judicial interpretation as is the RICO statute. The Clayton Act also provides for treble damages, 15 U.S.C. § 15 (1982), yet the *Mitsubishi* Court held that the availability of this remedy did not require that private antitrust claims be deemed nonarbitrable. 105 S. Ct. at 3359. It would appear therefore that determining statutory claims to be nonarbitrable on the basis of some judicially recognized public policy rather than as a matter of statutory interpretation is no longer permissible.

The absence of any RICO statutory provision that would bar arbitration does not, however, resolve both of the appeals presenting RICO claims. Because of the unique structure of the RICO statute, which cross-references other predicate statutes, we must, in making the statutory interpretation required by *Wilko* and *Mitsubishi*, look to those statutes as well.

The Securities Exchange Act of 1934 contains a statute that has been definitively construed by this court to preclude arbitration of claims for violation of section 10(b). If a sufficient number of section 10(b) violations have taken place to trigger the applicability of RICO, plaintiffs will in most cases plead a RICO claim in order to take advantage of the triple damage remedy that the RICO statute affords. There is no evidence that Congress intended that the availability of RICO remedies for section 10(b) should suspend the operation of the anti-waiver provision of the Securities Exchange Act of 1934. Because the heart of the dispute still will be over whether the securities laws were violated, RICO plaintiffs relying on section 10(b)

violations are, by virtue of section 29(a) of the 1934 Act, entitled to a judicial resolution of their RICO claims. Thus we will reverse the order in *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Nos. 85-3282, 85-3282, and 85-3345, compelling arbitration of a RICO claim based on section 10(b) predicate acts.

We reach a different conclusion in *Blumenthal v. Dean Witter Reynolds, Inc.*, No. 85-5552, in which the complaint pleads RICO claims predicated on violations of the federal mail-fraud statute, 18 U.S.C. § 1341 (1982), and wire-fraud statute, 18 U.S.C. § 1342 (1982), in addition to predicate act violations of section 10(b). *See* Complaint in *Blumenthal* at 13-14. The RICO claim based on section 10(b) violations is not subject to arbitration. The RICO claims predicated on mail and wire fraud, however, are arbitrable. No provision of the mail or wire fraud statutes bears any similarity to the anti-waiver provision of the 1933 and 1934 securities acts. The method of analysis required by *Wilko* and *Mitsubishi*, therefore, compels a different result. The RICO claims based on mail and wire fraud fall within the arbitration clause as written, and no federal statute prohibits application of the arbitration clause. The motion to compel arbitration of the RICO claims based on mail and wire fraud should have been granted.

CONCLUSION

In *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 85-3282, 85-3311, and 85-3343, we affirm the order denying the motion to compel arbitration of section 10(b) claims and reverse the order compelling arbitration of the RICO claim. In *Erlbaum v. Prudential-Bache Securities, Inc.*, No. 85-1541, we affirm the order denying the motion to

compel arbitration of the section 10(b) claims. In *Gant v. Kidder Peabody & Co.*, No. 85-5439, we affirm the order denying the motion to compel arbitration of the section 10(b) claims. In *Blumenthal v. Dean Witter Reynolds, Inc.*, No. 85-5552, we affirm the portion of the order denying arbitration of the section 10(b) claims and the portion of the order denying arbitration of the RICO claim based on section 10(b) violations, but we reverse the portion of the order denying arbitration of RICO claims predicated on mail and wire fraud. In *Burris v. Paine Webber, Jackson & Curtis, Inc.*, Nos. 85-5517 and 85-5542, we affirm the order refusing to compel arbitration of the section 10(b) claims.

ADAMS, Circuit Judge, concurring in part and dissenting in part.

These appeals question whether a party may insist on arbitration, pursuant to a predispute agreement, of a claim for relief under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission or under the Racketeer Influenced and Corrupt Organizations Act (RICO). I agree with the majority's disposition of the nonstatutory issues presented in the case, and, because of controlling precedent in this Circuit, I also agree that claims asserted under § 10(b) and Rule 10b-5 are not arbitrable. However, unlike the majority, I would hold that *all* RICO actions may be submitted to arbitration pursuant to the parties' valid agreement. Because my views differ from those expressed by the majority, I write separately.

I.

The question whether Rule 10b-5 actions against brokerage firms may be submitted to arbitration pursuant to a contractual agreement necessitates an analysis of a number of statutes and judicial decisions.

An appropriate starting point is the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982), which sets forth a federal policy favoring agreements to arbitrate. Section 2 provides, in part, that so long as the contract evidences a transaction involving commerce it "shall be valid, irrevocable, and enforceable, save upon any grounds as exist at law or in equity for the revocation of any contract." Section 3 requires that the district court stay pending actions where arbitration is appropriately invoked.

Despite the Federal Arbitration Act, passed in 1925, the Supreme Court held in *Wilko v. Swan*, 346 U.S. 427 (1953), that claims for relief under the antifraud provision in § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2) (1982), may proceed in a judicial forum regardless of any arbitration agreement between the parties. The Court reasoned that "§ 12(2) created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter." 346 U.S. at 431. In addition, the Supreme Court noted, the 1933 Act affords plaintiffs a choice of state or federal judicial forums, a broad choice of venue, and nationwide service of process. *Id.*; *see* § 22(a) of the 1933 Act, 15 U.S.C. § 77v(a) (1982). Because an agreement to arbitrate waives these procedural protections, the Court asserted, it violates the 1933 Act's "non-waiver" clause:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance

with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

§ 14, 15 U.S.C. § 77n (1982).

The *Wilko* Court explained that arbitration proceedings may lessen the protection Congress aimed to provide to investors through the Securities Act. "As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact'...cannot be examined." 346 U.S. at 436.

Section 10(b) of the 1934 Act is similar in many respects to § 12(2) of the 1933 Act, and the 1934 statute includes a non-waiver provision virtually identical to that found in the 1933 Act and relied upon in *Wilko*. *See* § 29(a) of the 1934 Act, 15 U.S.C. § 78cc(a) (1982). Further, the 1934 Act, like the earlier statute, contains special procedural rules, including exclusive federal jurisdiction and nationwide service of process. § 27, 15 U.S.C. § 78aa (1982). Thus, it could be argued that the *Wilko* holding, when logically extended, bars compelled arbitration of suits based on Rule 10b-5.

However, in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), a majority of five justices outlined a "colorable argument" that *Wilko* does not apply to Rule 10b-5 claims. *Id.* at 513. The Court stressed that unlike § 12(2), which provides an express right of action, the action based on § 10(b) and Rule 10b-5 is merely implied. In interpreting an implied cause of action, the Court suggested, a finding of congressional intent to create an exception to the Arbitration Act may not be warranted. *Id.* at 513-14. The four dissenting justices disagreed, arguing that the holding of nonarbitrability in *Wilko* required a similar result under the 1934 Act. *Id.* at 525. In any event, the majority chose not to

resolve the issue, since the case at hand involved a "truly international agreement" implicating unique policies and considerations of comity. *Id.* at 515.

Despite the reservations expressed by the Supreme Court in *Scherk*, two years later this Court held that Rule 10b-5 claims are not subject to arbitration agreements. *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir. 1976), *cert. denied*, 429 U.S. 1010 (1977). Although *Ayres*' consideration of the Rule 10b-5 issue was at best an alternative basis of the result reached, the Rule 10b-5 determination subsequently has been cited in this circuit as an independent and controlling holding. *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 940 n.17 (3d Cir. 1985).

The Court in *Ayres* stated that it was not "persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy" warrants a distinction between the express cause of action under § 12(2) and the implied right under § 10(b). *Id.* at 536. Similarly, in other circuits there has been "an almost universal tendency in these decisions to distinguish *Scherk*," *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 828 (10th Cir. 1978), and to follow *Wilko* in interpreting the 1934 Act in domestic disputes.[1]

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1. *See, e.g.*, Conover v. Dean Witter Reynolds, No. 85-6082 (9th Cir. July 17, 1986), McMahon v. Shearson/American Exp., Inc., 788 F.2d 94 (2d Cir. 1986); Sawyer v. raymond, James & Associates, Inc., 642 F.2d 791 (S.C. 1980); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1039 (6th Cir. 1979); MLPF&S, Inc. v. Moore, 590 F.2d 23 (Dec. 78); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-35 (7th Cir. 1977); Sibley v. Tandy Corp., 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976). However, a

Ayres paid particular attention to Congress' apparent acquiescence in the extension of *Wilko* by lower federal courts to bar arbitration of Rule 10b-5 claims. As the Supreme Court would later make clear, the primary consideration in determining the applicability of the Arbitration Act to a statutory cause of action is the intent of Congress. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 105 S. Ct. 3346, 3355 (1985). Thus, the *Ayres* court observed that, in 1975, Congress had amended § 28(b) of the 1934 Act, 15 U.S.C. § 78bb(b) (1982), to provide that disputes between members or participants in self-regulatory organizations, or between municipal securities dealers and brokers, may be arbitrated. The conference committee stated: "It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations." H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975), *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342. That the committee included this statement in amending the *1934* Act, the *Ayers* court concluded, suggests its belief that *Wilko* applies to causes of action under that Act. *See Ayres*, 538 F.2d at 537.

Whatever the merits of its reasoning, *Ayres* has not been undermined by subsequent developments. In *Dean Witter Reynolds, Inc. v. Byrd*, 105 S. Ct. 1238 (1985), the Supreme Court decided that the Arbitration Act required that state law claims pendent to nonarbitrable securities law counts be arbitrated, even

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split in the circuits has recently emerged with the Eight Circuit's opinion in Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 85-5156 (8th Cir. July 11, 1986), holding an arbitration clause valid and enforceable.

if the issues overlap and even if the result is piecemeal litigation. The Court noted, but again did not decide, that whether *Wilko* applies to suits under Rule 10b-5 is unresolved. *Id.* at 1240 n.1. Significantly, Justice White, who had joined the dissenters in *Scherk*, apparently reconsidered his views and wrote a concurring opinion reiterating the reservations expressed by the *Scherk* majority, "to emphasize that the question remains open and the contrary holdings of the lower courts must be viewed with some doubt." *Id.* at 1244. However, Justice White declined to articulate any considerations that were not expressed in *Scherk*, and therefore not presented to or examined by this Court in *Ayres*.

The other development since *Ayres* appears to be the growing judicial appreciation of and deference to arbitration as a means of alternative dispute resolution. This stance may be best discerned in a series of recent Supreme Court decisions enforcing the broad congressional mandate favoring arbitration. *See Mitsubishi, supra* (antitrust dispute arising out of international agreement is subject to arbitration); *Byrd, supra* (ordering arbitration of pendent state law claims); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (state laws undercutting the enforceability of arbitration agreements conflict with federal law and violate the Supremacy Clause); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983) ("The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration...").

Nevertheless, this significant trend does not undercut any of the considerations of congressional intent addressed in *Ayres*. To be sure, arbitration permits a speedy and much less expensive method of resolving many controversies than would be available

in a judicial forum, and this is especially salutary in view of crowded federal dockets and exorbitantly costly litigation. But I do not doubt the power of Congress to forbid arbitration of specified statutory claims. I do doubt, however, whether Congress has in fact forbade arbitration in regard to clause asserted under § 10(b).

While the Supreme Court may later take a different view of the issues addressed in *Ayres*, stare decisis requires that any panel of this court adhere to the undisturbed holding of a prior panel. *See Miller v. Drexel Burnham Lambert, Inc.*, No. 85-5692, slip op. at 3812 (11th Cir. June 17, 1986); *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 97 (2d Cir. 1986). Accordingly, although I have some reservations regarding the wisdom of nonarbitrability, I concur in the majority's conclusion that *Ayres* dictates in this Circuit the nonarbitrability of causes of action premised on Rule 10b-5.

The issue whether a 10b-5 claim may be subject to an arbitration agreement is a close and difficult one. Neither side of the argument is without merit. It is significant, however, that as the statute requires that any arbitration provision covering a "non-arbitrable" controversy be declared void and unenforceable, 15 U.S.C. § 78cc (a) & (b), the determination that Congress intended to render non-arbitrable implied rights of action under § 10(b) would mean that courts must refuse to give force to all agreements -- both pre- and post-dispute -- to submit such controversies to arbitration, even after arbitration has taken place.

Given that *Barrowclough* may have incorrectly treated *Ayers* as binding authority, and in view of the doubts raised as to the continued wisdom of the *Ayers* approach in light of subsequent Supreme Court statements and the split among the circuits, it might be advisable to reconsider this important and controversial issue *in banc*. Because of the split in the

circuits and the reservations in *Sherk* and *Ayres*, however, some uncertainty necessarily will remain until the Supreme Court speaks authoritatively to this issue. Since commercial relations affecting thousands of investors and scores of brokerage houses will remain in the shadow of doubt until then, an early definitive decision by the Supreme Court would be a helpful development.

II.

These appeals also present the difficult question whether RICO claims may be submitted to arbitration against a party's wishes, but in accord with a predispute agreement. Here, we are not encumbered by previous holdings since the issue of arbitrability in RICO situations is one of first impression in this Court.

In *Mitsubishi*, the Supreme Court squarely addressed whether a federal statutory right of action may be the subject of an arbitration agreement, and held that any statutory claim may be arbitrated if congressional intent to the contrary is not evident.

> Just as it is the congressional policy manifested in the federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable.

105 S. Ct. at 3355.

As Justice Stevens observed in dissent, the Court had not previously spoken clearly on the issue, although broad language in a series of earlier cases concerning labor arbitration could be read to imply the nonarbitrability of any federal statutory claim. For

example, in *McDonald v. City of West Branch*, 466 U.S. 284 (1984), the Court held that an unappealed arbitral decision pursuant to a collective bargaining agreement did not preclude a later civil rights suit under 42 U.S.C. § 1983 (1982) based on the same facts. The Court decided that "although arbitration is well suited to resolving contractual disputes...it cannot provide an adequate substitute for a judicial proceeding in protecting the federal statutory and constitutional rights that § 1983 is designed to safeguard." *Id.* at 290. *See also Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) (arbitration does not preclude suit under minimum wage provisions of the Fair Labor Standards Act); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974) (right to sue under Title VII of the Civil Rights Act of 1964 is not precluded by prior arbitral decision). In *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923 (3d Cir. 1985), this Court relied on these cases and ruled that purely statutory ERISA claims within the federal court's exclusive jurisdiction are not arbitrable. "There is an inherent incompatibility in referring to an arbitrator claims that fall within the exclusive jurisdiction of the federal courts and that arise as part of a comprehensive federal statutory scheme designed to assure protection to those individuals who fall within it." *Id.* at 940.

Mitsubishi spurned the basis proffered for this Court's decision in *Barrowclough*, stating that "we find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims." 105 S. Ct. at 3353. Although *Mitsubishi*, like *Scherk*, concerned an agreement to arbitrate disputes arising out of an international transaction, the *Mitsubishi* Court's rejection of a rule of nonarbitrability of statutory claims is stated in a portion of its opinion that is not

confined to the context of international agreements. Thus, *Mitsubishi* would appear to limit the effect of *McDonald*, *Barrentine*, and *Gardner-Denver*. At most, those cases may be seen as construing the intent underlying the particular statutes at issue, or as a rule of preclusion and not of arbitrability, or perhaps as a special presumption against labor arbitrators because of their limited expertise. *See Alexander*, 415 U.S. at 57 ("the specialized competence of arbitrators pertains primarily to the law of the shop, not the law of the land.").

Given that even a statutory cause of action is subject to the Arbitration Act, our task is to examine the text and legislative history of the RICO statute for any congressional intent to preclude arbitration of that private right of action. This search reveals no indication that Congress intended to exempt RICO actions from the provisions of the Arbitration Act. Further, none of the special statutory features that motivated the *Wilko* and *Ayres* decisions are found in the RICO statute. RICO has no non-waiver provision; indeed, even though it creates a private right of action it affords few procedural protections that would be waived by an agreement to arbitrate.[2] Not only is the statute silent on the arbitration issue, but the legislative history offers no indication that Congress intended to bar arbitration of private RICO actions.

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2. For example, the statute provides for federal jurisdiction over private claims, but does not specify whether such jurisdiction is exclusive. The courts that have addressed the issue are divided on the question. *Compare Chas. Kurz Co. v. Lombardi*, 595 F. Supp. 373, 381 n.11 (E.D. Pa. 1984) (concurrent) *with Kinsey v. Nestor Exploration Ltd. - 1981A*, 604 F. Supp. 1365, 1370-71 (E.D. Wash. 1985) (exclusive). *Cf. Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 478 (1981) (where statute is silent, presumption favors concurrent jurisdiction).

Accordingly, those seeking to avoid arbitration of RICO claims rely primarily on considerations of public policy. They insist that arbitrators, whose decisions are not subject to thorough review, should not be responsible for developing this evolving area of law, and that RICO embodies vital federal policies which should be litigated in a judicial forum. Relying on these arguments, the Second Circuit recently ruled that agreements to arbitrate RICO claims are unenforceable. *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98 (2d Cir. 1986).[3] The Second Circuit rested its view on *American Safety Equipment Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), in which it had held that actions under the Sherman Act are not arbitrable.

In *Mitsubishi*, the Supreme Court declined to accept the *American Safety* rule as applied to antitrust disputes arising out of international agreements. And although, as *McMahon* observes, the Court carefully limited its holding to the international context, *see* 105 S. Ct. at 3355, its reasoning casts grave doubt on the Second Circuit's broad conception of "the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved." *McMahon*, 788 F.2d at 98.

The notion that judicially decreed public policy determines the arbitrability of particular disputes is inconsistent with the Supreme Court's instruction that only the congressional intent expressed in a statute or its legislative history is relevant to the issue.

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3. The Fifth Circuit also reached the conclusion that RICO claims are nonarbitrable, but later vacated that ruling so that the district court could consider the applicability of *Mitsubishi* to the issue. Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 785 F.2d 1274, 1281 (5th Cir. 1986), *vacated in part*, No. 85-1310 (5th Cir. May 13, 1986) (per curiam).

Second, the *Mitsubishi* Court itself "confess[ed] to some skepticism of certain aspects of the *American Safety* doctrine." 105 S. Ct. at 3357. In particular, it rejected the notion that where a statute implicates important public policy a judicial forum is required. Justice Blackmun wrote: "[S]o long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Id.* at 3358-59.

It seems clear, therefore, that public policy considerations do not compel the nonarbitrability of RICO claims. To this extent, the majority and I agree. We part company, however, over the notion that the arbitrability of RICO actions turns on the nature of the predicate offenses underlying such actions.

The majority appears to base its position primarily on its concern regarding the effect of a contrary holding: that Rule 10b-5 claims would not be arbitrable pursuant to the rule of *Ayres*, while a RICO claim predicated on an identical Rule 10b-5 violation may be submitted to arbitration. In stating that this result is unwarranted, the majority declares: "There is no evidence that Congress intended that the availability of RICO remedies for section 10(b) should suspend the operation of the anti-waiver provision of the Securities Exchange Act of 1934." Majority Typescript at 17.

This reasoning, I believe, misconceives the appropriate inquiry. The focus must be on whether in enacting a law Congress intended to prevent waiver of the right to a judicial forum; *lack of evidence* that Congress intended to allow arbitration is insufficient to defeat the strong presumption in favor of arbitration set forth in the Arbitration Act. "We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that

intention will be deducible from text or legislative history." *Mitsubishi*, 105 S. Ct. at 3355. Further, I do not agree that an action under RICO must be treated for purposes of arbitrability as an action under the securities laws whenever it is based upon a predicate offense that violates Rule 10b-5, as the majority's statement above would suggest.

A private right of action under RICO is a unique and separate claim to which the Arbitration Act logically applies. RICO is a manifestation of congressional concern with the special harm caused by those who engage in a pattern of wrongful offenses, and the private right of action under the RICO statute is distinct from one based on an underlying offense alone.

The structure of the legislation illustrates the distinction. The statute provides a lengthy list of predicate offenses, ranging from broadly described state criminal offenses such as "gambling" and "robbery" to numerous federal criminal, bankruptcy, and securities law provisions. *See* 18 U.S.C. § 1961(1) (1982). It then proscribes, in part, the operation of any enterprise engaged in or whose activities affect interstate or foreign commerce, using income derived from a "pattern of racketeering activity," *id.* at § 1962, defined as the commission of at least two predicate offenses within a ten-year period, *id.* at § 1961(5). Further, an individual may maintain a private claim for injuries suffered as a result of such racketeering activity. *Id.* at § 1964(c).

Given the clear distinction between the nature of a RICO violation and any particular predicate offense, the congressional intent in passing the Securities Exchange Act would not appear to be relevant in an inquiry into the legislative purpose animating RICO. And, focusing solely on the latter inquiry, as noted earlier there is simply no indication that Congress

intended to foreclose application of the Arbitration Act to RICO claims.

To be sure, the position that all RICO claims are arbitrable, regardless of the predicate offenses averred, would lead to piecemeal litigation. Where a pre-dispute agreement to arbitrate had been entered into, a RICO claim based on Rule 10b-5 violations would proceed in an arbitral forum, while a securities claim based upon similar facts would be litigated in federal court. The issue of what preclusive effect, if any, should be accorded either decision is not before us.

While this may not be an optimum use of adjudicative resources, it is the inevitable result where Congress specifies the nonarbitrability of a few statutory provisions and applies the sweeping Arbitration Act to all others. It is also consistent with the Supreme Court's action in *Byrd*, where it adhered to the Act's mandate and ordered the arbitration of pendent state law claims, while a Rule 10b-5 action concerning the same transactions and alleged wrongs continued in federal court. As the Supreme Court stated in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 20 (1983): "[F]ederal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Id.* at 20 (emphasis in original). Should Congress desire a different result, it, of course, may so legislate.

In contrast to the result I advocate, the majority's approach not only bifurcates the proceedings, but also compels an unwarranted division of a plaintiff's single RICO claim. It suggests that where a RICO count is predicated on arbitrable and nonarbitrable offenses the RICO claim itself will be split and heard in separate proceedings. Thus, in *Blumenthal v. Dean Witter Reynolds, Inc.*, No. 85-5552, where plaintiff's complaint stated only a single count based on RICO, the ruling by the majority would divide that count in

order to allow for arbitration of the mail and wire fraud issues and litigation in a court of the securities issues -- despite the fact that the unique RICO offense depends, in this case, on whether the enterprise has engaged in mail and wire fraud *as well as* securities fraud within a ten-year period.

In my view, the position reached by the majority today fails to take note of the unique nature of a RICO violation, and the broad directive set forth in the Arbitration Act.

III.

Accordingly, while I concur in the decision regarding the nonarbitrability of Rule 10b-5 claims, primarily because of prior holdings of this Court, and the arbitrability in general of RICO claims, I respectfully dissent to the extent the majority in *Blumenthal* and in *Jacobson v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, Nos. 85-3282, 85-3311 and 85-3343, forbids the arbitration of RICO claims that are predicated on Rule 10b-5 violations.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

BEST AVAILABLE COPY

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 85-5517 & 85-5542

MARILYN E. BURRIS, residing Claridge House
No. 2 Verona, New Jersey

vs.

PAINE, WEBER, JACKSON & CURTIS, INC.,
SMITH, BARNEY, HARRIS, UPHAM & CO., INC.,
and DONALD J. PORTER

Smith Barney, Harris Upham & Co., Inc.,
Appellants in No. 85-5517

Paine Webber Jackson & Curtis, Inc., and
Donald J. Porter, Appellants in No. 85-5542

(D.C. Civ. No. 83-3087)

ON APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Present:

ADAMS, GIBBONS and MANSMANN, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was submitted under Third Circuit Rule 12(6), April 14, 1986.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered July 24, 1985, be, and the same is hereby affirmed. Costs taxed against the appellants. All of the above in accordance with the opinion of this Court entered in appeal Nos. 85-1541, 85-3282, 85-3311, 85-3343, 85-5439, 85-5517, 85-5542 and 85-5552.

ATTEST:

Deputy Clerk

August 11, 1986

Certified as a true copy and issued in lieu of a formal mandate as to No. 85-5542 Only on September 2, 1986.

Teste:

Clerk, United States Court of Appeals, for the Third Circuit

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

MARILYN BURRIS,

Plaintiff,

-vs-

PAINE, WEBBER, JACKSON & CURTIS, INC., SMITH BARNEY, HARRIS UPHAM & CO., INCORPORATED and DONALD J. PORTER,

Defendants.

BENCH OPINION

Civil Action No. 83-3087
August 3, 1984
Newark, New Jersey

BEFORE:

HONORABLE H. LEE SAROKIN, U.S.D.J.

THE COURT: The issues presented by this matter are particularly troublesome, because of the relative positions of the parties to the agreement. Plaintiff, a customer of the defendant stockbrokers, signed a standard form agreement by which she submitted all state common law claims to arbitration. It is unlikely that she and most persons similarly situated know and understand the significance of such an agreement, assuming they have read it, which is unlikely.

The enforcement of such an agreement has at least two significant results. The customer may be required to litigate the underlying facts twice and surrenders his or her claim under state law for punitive damages.

These rather unfortunate results must be weighed against the policy of encouraging arbitration and furthering the stability of contracts in the business world. The better practice would be to spell out for the customer the significance of an agreement to arbitrate. However, having failed to do so, the Court cannot conclude that such failure renders the agreement unenforceable as a matter of law. If there has been fraud or a contract of adhesion, those matters may be presented in the arbitration proceeding. As in any form contract, adverse provisions may deprive the unsophisticated consumer of certain rights and remedies. However, having agreed to arbitrate, it would not be appropriate for this Court not to enforce that agreement.

Plaintiff Marilyn Burris filed this suit against defendants Paine, Webber, Jackson & Curtis, Inc. (Paine Webber), Smith, Barney, Harris, Upham & Co., Inc. (Smith Barney) and Donald J. Porter on August 17, 1983. Plaintiff's complaint contains federal claims for fraud, deception and other federal securities laws violations, as well as state law claims. The plaintiff is a former customer of the defendants who alleges that their conduct caused her economic loss. Defendant Porter is a registered broker who was employed, at all times relevant to this action, by either Paine Webber or Smith Barney.

In addition to her federal securities law claims, Ms. Burris alleges violations of state common law. Ms. Burris' margin agreement with the defendants contains an arbitration clause. The defendants now move under the United States Arbitration Act, 9 U.S.C. §1 *et. seq.*, to compel arbitration of these state law claims.

The plaintiff's margin agreement with Paine Webber Jackson & Curtis provides:

> Any controversy between us arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the New York Stock Exchange, American Stock Exchange,

> National Association of Securities Dealers, or where appropriate, Chicago Board Option Exchange or Commodities Futures Trading Commission as I may elect. I authorize you if I do not make such election, by registered mail addressed to you at your main office within fifteen (15) days after receipt of notification from you requesting such election, to make such election in my behalf. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators or of a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

Ms. Burris' agreement with Smith Barney Harris Upham & Co. is essentially identical for purposes of this motion.

There is a strong federal policy supporting contractually bargained for arbitration. *Moses H. Cone Memorial Hospital v. Mercury Construction*, ____ U.S. ____ , 103 S.Ct. 927 (1983). Arbitration provides the parties with a quick, relatively inexpensive trial before specialists in the field. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). Therefore, any questions regarding the applicability of an arbitration clause should be resolved in favor of arbitration. *Stateside Machinery Co., Ltd. v. Alperin*, 591 F.2d 234, 240 (3d Cir. 1979).

All parties agree that arbitration agreements are unenforceable as to federal securities law violations. *Wilko v. Swan*, 346 U.S. 427 (1953). Ms. Burris has a non-waivable right to have her federal securities law claims adjudicated by this Court. She is further requesting that the Court retain pendant jurisdiction over her state law claims under the doctrine of "intertwining." She also contends that the arbitration agreement is a contract of adhesion.

The question presented is a difficult one. When an action is brought pursuant to the federal securities laws and state law claims are also asserted, if the state and federal claims are factually related, should an arbitration clause covering only the state law claims be enforced as to those claims?

The doctrine of intertwining finds an exception to the federal pro-arbitration scheme, "when it is impossible to separate out non-arbitrable from arbitrable contract claims . . . in order to preserve [the court's] exclusive jurisdiction over federal security act claims." *Sibley v. Tandy*, 543 F.2d 540, 543 (5th Cir. 1976), *rehearing denied* 547 F.2d 286, *cert. denied*, 434 U.S. 824 (1977). Under "intertwining" the state law claims are retained when the same "ultimate facts" underlie the state and federal claims, in order to ensure that the federal forum is able to make its determination of the securities law claims unconstrained by any prior adjudicative determination. *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318, 336 (5th Cir. 1981). *See also Byrd v. Dean Witter Reynolds, Inc.*, 726 F.2d 552 (9th Cir. 1984), *cert. granted*, No. 83-1708 (June 11, 1984); *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023 (11th Cir. 1982). In applying the intertwining doctrine the courts have advanced primarily two rationales: first, that a court applying the securities laws might be bound by a factual determination made by the arbitrators; and second, that a split trial involves duplication of effort and is therefore inefficient and contrary to the goal of arbitration to provide speedy and inexpensive dispute resolution.

Other courts have rejected the doctrine of intertwining. In *Liskey v. Oppenheimer & Co., Inc.*, 717 F.2d 314 (6th Cir. 1983), the court rejected the doctrine and reversed an order of the district court denying the motion to sever, stay, and compel arbitration of state law claims. The court followed a decision of the Seventh Circuit, *Dickinson v. Heinold Securities, Inc.*, 661 F.2d 638 (7th Cir. 1981):

> We hold, therefore, that the district court may not refuse to enforce an agreement to arbitrate because of the joinder of a nonarbitrable claim, even when a bifurcated resolution may result in an assertedly inefficient or delayed resolution of the entire dispute.

661 F.2d at 646.

Very recently the Eighth Circuit Court of Appeals rejected the doctrine of intertwining in a case where state law claims were

joined with claims under the federal securities laws. *Surman v. Merrill Lynch, Pierce, Fenner & Smith*, 733 F.2d 59 (8th Cir. 1984). The court considered the authorities on both sides of this controversial issue and determined that the district court had erred in failing to compel arbitration of the state law claims. The court concluded that the "concern over exclusive federal jurisdiction can be effectively addressed by controlling the sequence of the court and arbitration proceedings." *Id.* at 62. The court also found that concerns for efficiency are not sufficient grounds to prevent arbitration of otherwise arbitrable claims. *Id.* at 63. In reaching this latter conclusion the court took guidance from *Moses H. Cone Memorial Hospital*, 103 S. Ct. at 939, in which the court was faced with a petition to compel arbitration in a situation where related non-arbitrable claims were pending in state court. The court concluded that a party may be required to resolve related disputes in different forums "because the relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." (footnote omitted).

The parties agree that the Court of Appeals for the Third Circuit has not yet decided this controversial question. The parties have presented conflicting district court authorities from within this circuit on this question.

In *Ging v. Parker-Hunter, Inc.*, 544 F. Supp. 49 (W.D. Pa. 1982), the court was faced with a complaint containing both federal securities laws and state law claims, and with an agreement to arbitrate disputes. The court concluded that "the proper accommodation between the strong federal policy to recognize the contractual choice of an arbitration forum . . . (citation omitted) and a plaintiff's absolute right to have his federal security claims heard in federal court . . . (citation omitted) is to sever the common-law claims, order them to arbitration, and stay the arbitration until the federal security claims have been resolved." *Id.* at 55.

One court in this district has adopted the doctrine of intertwining. *Breyer v. First National Monetary Corp.*, 548 F. Supp. 955, 962 (D.N.J. 1982). In *Breyer* the plaintiffs asserted claims under the federal securities laws, the Commodity Exchange Act, and the

common law. The court stayed arbitration initiated by the defendant, finding "that the arbitrable claims cannot be separated from the non-arbitrable CEA claims." *Id.* at 962.

This Court is persuaded that the doctrine of intertwining may not be applied in this case to prevent arbitration of the state law claims. Although the question is a controversial one, and there are merits in the positions advanced by both sides on the question, the Court follows those other courts that have rejected the doctrine of intertwining.

The appropriate method of ensuring that the court's determination of the security law claims will not be hindered by a prior arbitration is to stay arbitration of the state law claims pending resolution of the federal claims. *Dickinson v. Heinhold Securities*, 661 F.2d at 664; *Lee v. Ply*Gem Industries, Inc.*, 593 F.2d 1266 (D.C.Cir.), *cert. denied*, 441 U.S. 967 (1979); *Ging v. Parker-Hunter*, 544 F. Supp. 49 (W.D. Pa. 1982). In so doing the Court respects Congress' conclusion that the federal courts should make the ultimate determination on federal securities law violations while preserving the federal policy favoring arbitration agreements. Similarly, the staying of arbitration until resolution of the securities claims avoids placing the Court in a position where it may be bound by the ultimate factual conclusions of the arbitrators.

This Court is persuaded that the doctrine of intertwining may not be applied in this case to prevent arbitration of the state law claims. Although the question is a controversial one, and there are merits in the positions advanced by both sides on the question, the Court follows those other courts that have rejected the doctrine of intertwining.

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while preserving the federal policy favoring arbitration agreements. Similarly, the staying of arbitration until resolution of the securities claims avoids placing the Court in a position where it may be bound by the ultimate factual conclusions of the arbitrators.

The argument that arbitration in this context leads to an inefficient bifurcated trial does not overcome the strong federal policy favoring arbitration. *Liskey*, 717 F.2d at 318; *Dickinson*, 661 F.2d at 644-45. The Supreme Court recently stated in *Moses H. Cone* that bifurcation may be necessary "because the relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Moses H. Cone*, 103 S. Ct. at 939 (emphasis in original). There are several ways that the duplication of a bifurcated trial can be reduced. The jury in the federal securities case could be given a special verdict. These findings of fact could have collateral estoppel effect in the arbitration and reduce the duplication of proofs by the plaintiff. *Dickinson*, 661 F.2d at 645. As a practical matter, disposition of the federal securities claims is likely to lead to a settlement of, or a decision not to pursue, the state law claims.

Ms. Burris further argues that the arbitration agreement should not be enforced since her margin agreements with the defendants were contracts of adhesion. She contends that she was induced to sign the Agreement as a prerequisite to maintenance of her accounts at either of defendant brokerage houses and that she did not affirmatively assent to arbitration of any future claims, nor did she intend to waive her right to pursue judicial remedies.

The Supreme Court has held that fraud in the inducement of an arbitration agreement is an issue to be determined by the federal courts, while fraud in the inducement of the overall contract is an issue of fact to be determined by the arbitrators. *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). Section 4 of the Arbitration Act, 9 U.S.C. §4, states, in part, "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is *not* an issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement" (em-

phasis added). In construing this language, the Court stated:

> Accordingly, if the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the "making" of the agreement to arbitrate – the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.

Prima Paint, supra at 403-404. *See also Moses H. Cone*, ____ U.S. ____, 103 S. Ct. at 941.

Ms. Burris' allegations that she was induced to sign the margin agreements and that she was not aware that they were contracts do not constitute a claim of inducement in the signing of the arbitration agreement. Similarly, her claims that they were adhesion contracts and unconscionable do not relate to the making of the arbitration agreement and must be decided by the arbitrators. *See Merrill, Lynch, Pierce, Fenner & Smith v. Haydu*, 637 F.2d 391, 398 (5th Cir. 1981).*

Ms. Burris supports her position that the boiler-plate contract language constitutes fraud in the arbitration agreement under *Prima Paint, supra*, by reference to S.E.C. Release No. 34-15984 (July 2, 1979), CCH Fed. Sec. L, Rep. 82, 122 (1979 Transfer Binder). This release instructs the brokerage firms to state in their arbitration agreements that federal securities claims are not arbitrable. The arbitration agreements in question do not include this language. Ms. Burris then notes a New York court opinion refusing arbitration because the arbitration clause was not in com-

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* It is difficult to know precisely the content of plaintiff's allegations of fraud. These allegations are not supported by facts in an affidavit; the court has only representations in briefs. This is one additional reason why the arbitration cannot be avoided on this ground. *See Kroog v. Mait*, 712 F.2d 1148, 1151 n.1 (7th Cir. 1983), *cert. denied*, ____ U.S. ____, 104 S.Ct. 1001 (1984) (the court refused to consider a claim that a contract containing an arbitration clause was a contract of adhesion when that claim was belated and unsupported by record evidence).

pliance with Release No. 34-15934. *Bear Sterns & Co. v. Weiss*, 429 N.Y.S. 2d 156 (Sup. Ct. 1980). The *Weiss* decision is not persuasive. Merely because the arbitration agreement fails to state that federal securities claims are not arbitrable does not mean that it should be disregarded by a federal court as to arbitrable state claims. In fact, a New York Appellate Court has expressly rejected the *Weiss* holding:

> Significantly, in the period since the issuance of the Release, no court, with the exception of *Weiss*, has ever relied upon it to vitiate an arbitration agreement in a dispute limited to common law claims. Where the claims asserted do not involve Securities Act violations, broad pre-dispute arbitration clauses continue to be enforced, even where no mention of non-arbitrability of Securities Act claims is made.

Harris v. Shearson Hayden Stone, Inc., 441 N.YS.. 2d 70, 73 (Sup. Ct. App. Div. 1981), *aff'd.* 450 N.Y.S. 2d 482 (Ct. of App. 1982).

Ms. Burris finally notes that under applicable New York law arbitrators cannot award punitive damages. *Garrity v. Lyle Stuart Inc.*, 40 N.Y.2d 354, 386 N.Y.S. 2d 831 (1976). Nor are punitive damages available under the Securities laws. *Straub v. Vaisman & Co., Inc.*, 540 F.2d 591 (3d Cir. 1976). She argues, therefore, that her state law claims should be retained by the Court since referral to arbitration would deny her this remedy. However, there is no reason why an otherwise valid arbitration agreement should be denied effect merely because it limits the remedies to which the plaintiff is entitled. The plaintiff is presumed to have knowledge of the applicable state law. By signing an agreement to arbitrate she may have waived her right to punitive damages. *Surman*, 733 F.2d at 63; *Baselski v. Paine, Webber, Jackson & Curtis, Inc.*, 514 F. Supp. 535 (N.D. Ill. 1981).

Ms. Burris' claims of state law violations are referred to arbitration as required by the brokerage contract. However, the arbitration of these claims will be stayed pending resolution of the alleged federal securities law violations by this Court.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 83-3087

MARILYN BURRIS,

Plaintiff,

vs.

PAINE WEBBER, JACKSON & CURTIS, INC., SMITH BARNEY HARRIS UPHAM & CO., INC. and DONALD J. PORTER,

Defendants.

ORDER

This matter having been opened to the Court by motion of Shanley & Fisher, P.C. (attorneys for defendant Smith Barney, Harris Upham & Co.) and Hannoch, Weisman, Stern, Besser, Berkowitz & Kinney. P.A. (attorneys to defendants Paine Webber, Jackson & Curtis, Inc. and Donald J. Porter), to sever the state law claims and compel arbitration of those claims, and the court having considered the papers submitted in support and opposition and the arguments of counsel, and good cause appearing;

It is on this 2nd day of August, 1984;

ORDERED, that the motion is granted and the state law claims shall be severed and referred to arbitration;

FURTHER ORDERED, that the arbitration of these claims is stayed pending the outcome of this action.

s/H. Lee Sarokin
H. Lee Sarokin, U.S.D.J.

Original Filed August 2, 1984
Entered on the Docket on August 3, 1984

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil 83-3087

MARILYN BURRIS,

Plaintiff,

vs.

PAINE WEBBER, JACKSON & CURTIS, INC.; SMITH BARNEY, HARRIS UPHAM & CO. INCORPORATED and DONALD J. PORTER,

Defendants.

BEFORE:

HON. H. LEE SAROKIN, U.S.D.J.

Newark, New Jersey

July 8, 1985

BENCH OPINION

THE COURT: This is a motion to reconsider the court's August 2, 1984, Bench Opinion in this matter in light of the Supreme Court's recent decision in *Dean Witter Reynolds, Inc. v. A. Lamar Byrd*, 53 U.S.L.W. 4222 (March 4, 1985). In its August opinion, this court granted the defendants' motion to compel arbitration of plaintiff's state law claims, but stayed arbitration pending resolution of the plaintiff's federal securities claims. The court did not order arbitration of the securities claims, noting that "[a] ll parties agree that arbitration agreements are unenforceable as to federal securities laws violations", and citing *Wilko v. Swan*, 346 U.S. 427 (1953). Bench Opinion at 4. Defendants now argue that

the court's decision to stay arbitration should be reconsidered in light of *Dean Witter*, and that arbitration of the federal securities claims should also be compelled in light of that decision. The court agrees with the defendants' first point, but disagrees with regard to the second.

Dean Witter resolved a conflict among the circuit courts of appeals as to how to treat agreements to arbitrate disputes between brokers and clients when a disgruntled client brings suit against his broker on both state law and federal securities grounds. Relying on *Wilko v. Swan, supra*, lower courts have consistently held that arbitration agreements are not enforceable in connection with federal securities claims. *See Dean Witter*, 53 U.S.L.W. at 4222 n. 1 and cases cited. To resolve the anomaly of having arbitration proceedings and a federal court action proceed simultaneously, courts have either refused to compel arbitration of the plaintiff's state law claims under a theory that the state claims were inextricably "intertwined" with the federal claims, *see e.g., Belke v. Merrill Lynch, Pierce, Fenner, & Smith*, 693 F.2d 1023 (11th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318 (5th Cir. 1981), or they have compelled arbitration of the state claim, but stayed the arbitration pending resolution of the federal securities claims. *See e.g., Surman v. Merrill Lynch, Pierce, Fenner & Smith*, 733 F.2d 59 (8th Cir. 1984); Dickinson v. Heinhold Securities, Inc., 661 F.2d 638 (7th Cir. 1981). This court followed the latter course in its August ruling.

In *Dean Witter*, the Supreme Court held that the Arbitration Act requires courts to compel arbitration of state law claims in a securities case, "even if the result is 'piecemeal' litigation". 53 U.S.L.W. at 4224. Neither the interest in speedy resolution of disputes nor concerns over the possible collateral estoppel effect that an arbitration proceeding might have in a concurrent federal action justify the failure to compel arbitration in light of the mandate in the Arbitration Act. Moreover, *Dean Witter* made clear that "there is no reason to . . . manipulate the ordering of . . . bifurcated proceedings, simply to avoid an infringement of federal interests." 53 U.S.L.W. at 4224-25. Citing its holding in *McDonald v. City of West Branch*, 104 S.Ct. 1799 (1984) (arbitration proceeding had no collateral estoppel effect in subsequent

federal action under 42 U.S.C. §1983), the Court all but laid to rest any fears that arbitration proceedings might have a preclusive effect in subsequent federal proceedings. Dean Witter thus obviated any possible rationale for staying arbitration pending resolution of federal claims. Accordingly, the court will reconsider its order insofar as it stayed arbitration of plaintiff's state law claims and will vacate the stay.*

Dean Witter did not make any such pronouncement with regard to the enforcement of arbitration agreements in the context of federal securities claims. Indeed, the Court expressly noted that that question was not before it. 53 U.S.L.W. at 4222-23 n. 1. The Court did cast some doubt, however, on whether *Wilko v. Swan* necessarily barred enforcement of arbitration agreements in the context of causes of action implied under the Securities and Exchange Act of 1934, as exist here. The Court noted that *Wilko* by its terms applied only in the context of certain express statutory claims arising under the Securities Act of 1933. The Court pointed out that

> in *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974), this Court questioned the applicability of *Wilko* to a claim arising under §10(b) of the Securities Exchange Act of 1934, or under Rule 10b-5, because the provisions of the 1933 and 1934 Acts differ, and because, unlike §1292 of the 1933 Act, §10(b) of the 1934 Act does not expressly give rise to a private cause of action. 417 U.S., at 512-13.

53 U.S.L.W. at 4222 n. 1. The Court went on to say that "the Court did not, however, hold that *Wilko* would not apply in the

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* In his brief response to defendants' lengthy submission, plaintiff's counsel asks the court not to vacate its stay of arbitration on the grounds that "at this late date it would unfairly prejudice the plaintiff . . . " Plaintiff's Mem. at 4. Plaintiff's counsel offers no amplification of his claim of prejudice, nor can the Court conceive of how the timing of this reconsideration of its previous order will prejudice plaintiff. In light of the Supreme Court's assurance that any arbitration findings would have no preclusive effect in this action, plaintiff could not be prejudiced by an order compelling arbitration, regardless of when it is issued.

considerable vitality in the lower federal courts. Indeed, numerous District Courts and Courts of Appeals have held that the *Wilko* analysis applied to claims arising under §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and that agreements to arbitrate such claims are therefore unenforceable." *Id.* Justice White wrote separately "to emphasize that the question remains open and the contrary holdings of the lower courts must be viewed with some doubt." *Id.* at 4225.

Relying upon this language, defendants urge the court to rule that arbitration agreements are enforceable where causes of action implied under the Exchange Act are involved, as is the case here. In so doing, the defendants ask the court to contravene clear Third Circuit precedent. In *Ayres v. Merrill Lynch, Pierce, Fenner & Smith*, 538 F.2d 532 (3d Cir. 1976), *cert. denied*, 429 U.S. 1010 (1977), the Third Circuit ruled that a New York Stock Exchange rule requiring arbitration of disputes was unenforceable in the context of disputes involving claims under the Exchange Act. The court noted that

> "[a]s Merrill Lynch points out, a 'colorable argument can be made' that *Wilko v. Swan* should not apply to arbitration of judicially implied causes of action under the 1934 Act. We are not, however, persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrants such a distinction. And we note that Congress appears to have accepted the view that *Wilko v. Swan* applies in the 10b-5 context. *Cf.* H.R. Rep. No. 94-229, 94th Cong., 1st Sess., at 111 (1975), U.S. Code Cong. & Admin. News 1975, p. 321.

538 F.2d at 536-37. In an accompanying footnote, the court also acknowledged the doubts raised by *Scherk:*

> This "colorable argument" was mentioned, but not explored, in *Scherk v. Alberto Co.*, . . . a 5-4 decision in which the Court accepted the premise that *Wilko v. Swan* was applicable. The Court noted that the 10b-5 cause of action is judicially implied whereas §12(2),

> [which was at issue in Wilko] expressly provides a private cause of action, and that the 1934 Act vests exclusive jurisdiction in the federal courts while the 1933 Act grants concurrent federal and state jurisdiction.

Id. n. 12. Nothing in *Dean Witter* changes the Third Circuit's analysis in *Ayres* or resolves any of the questions raised in *Scherk*, which were before the Court in *Ayres*. The issues raised by the defendants have thus already been considered by the court of appeals for this circuit and resolved against arbitration in Exchange Act cases. *Ayres* is still good law in this circuit, even after *Dean Witter*. In the absence of any contrary authority, this court remains bound by *Ayres*. Defendants' motion to compel arbitration of plaintiff's federal securities claim is therefore denied.

CONCLUSION

Defendants' motion for reconsideration of the Court's August order is granted in part and denied in part. The Court will vacate its order staying arbitration of the plaintiff's state law claims, but will deny defendants' request to compel arbitration of plaintiff's federal securities claims.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Civil Action No. 83-3087

MARILYN E. BURRIS, residing Claridge House No. 2
Verona, New Jersey,

Plaintiff,

vs.

PAINE, WEBBER, JACKSON & CURTIS, INC.,
SMITH BARNEY, HARRIS UPHAM & CO., INC.
and DONALD J. PORTER,

Defendants.

ORDER

The Honorable H. Lee Sarokin

THIS MATTER HAVING BEEN brought before the Court by Shanley & Fisher, P.C., attorneys for the defendant Smith Barney, Harris Upham and Co. Inc., joined by Hannoch Weisman, attorneys for the defendants Paine, Webber, Jackson & Curtis, Inc. and Donald J. Porter, and in the presence of Dennis A. Durkin, Esq., attorney for the plaintiff Marilyn E. Burris, on motion for an Order (1) vacating that part of this Court's August 2, 1984 Order which had previously stayed the arbitration of plaintiff's pendent state law claims; and (2) compelling the arbitration of plaintiff's implied federal securities law claims under Section 10 (b) of the 1934 Securities Exchange Act, 15 USC § 78j(b) and SEC Rules 10b-3 and 10b-5 promulgated thereunder, 17 C.F.R. Section 240. 10b-3 and 10b-5, and this Court having considered all papers submitted in support of and in opposition to said motion, and for good cause shown,

IT IS ON THIS 22nd day of July 1985,

ORDERED that the previously imposed stay of the arbitration of plaintiff's pendent state law claims be and the same is hereby vacated; and it is further

ORDERED that the defendants' motion to compel the arbitration of plaintiff's implied federal securities law claims under Section 10(b) and Rules 10b-3 and 10b-5 be and the same is hereby denied.

s/H. Lee Sarokin

H. LEE SAROKIN, U.S.D.J.

Original Filed July 22, 1985
Entered on the Docket on July 24, 1985

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 85-5517

MARILYN E. BURRIS, et al

vs.

PAINE, WEBER, JACKSON & CURTIS, INC., et al.

SMITH BARNEY, HARRIS UPHAM & CO., INC., APPELLANTS

Pursuant to Rule 41(b) of the Federal Rules of Appellate Procedure, it is ORDERED that issuance of the certified judgment in lieu of formal mandate in the above cause be, and it is hereby stayed until October 1, 1986.

/s/ John Gibbons
Circuit Judge

Dated: September 8, 1986

APPENDIX D

STATUTES AND REGULATIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l(2):

> Any person who—
>
> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15, U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v:

(a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Tile 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. § 78j(b):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 29(a), 15 U.S.C. § 78cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Securities and Exchange Commission,

Rule 10b-5, 17 C.F.R. § 240.10b-5:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.